The CMAR and extent of compliance with IFRS 101 standard among Malaysian ace market companies

Nor Asma Lode[*]

School of Accountancy, College of Business,
Universiti Utara Malaysia, Kedah, Malaysia

Abstract

Malaysia is on the track to achieve full convergence and adoption of the International Financial Reporting Standards (IFRSs) by 2012. This study seeks to find out the extent of compliance with IFRS 101 'Presentation of Financial Statements' before the effective date. Using total disclosure index (TDI), the findings shows that most of Malaysian Ace Market companies have complied with IFRS 101. The present study also indicates that the Cumulative Market Adjusted Return (CMAR) is positive and significant for both partial and full compliance of IFRS 101 among the Malaysian Ace Market companies. Multivariate regression analysis further provides a lack of significant association between CMAR and announcement of earnings (i.e. EPS). Nevertheless, the percentage of independent directors on the board (BDIND) is found to be a positive and a significant corporate governance variable that associates with CMAR. These findings imply that policy makers and regulators should encourage Ace Market companies to have the most optimal number of independent board of directors for future improvements of CMAR.

*Keywords***:** IFRS 101, CMAR, Ace Companies, total disclosure index

1.0   Introduction

Malaysia is on the track to achieve full convergence and adoption of the International Financial Reporting Standards (IFRSs) by 2012. In view of that, the Malaysian Accounting Standards Board (MASB) has required all listed companies to comply with the new accounting standard which resemble closely with the IFRS issued by the International Accounting Standards Board (IASB) starting from 1st January 2006. Hence, this study provides recent findings on the compliance with IFRS 101 'Presentation of Financial Statements'. Given that IFRS 101 is important and affects other accounting standards used by a particular company, this study aims to fill gaps

[*] Corresponding author: Tel: +604-9287291
  E-mail address: asma@uum.edu.my

and provide new evidence on the market reaction on the extent of compliance with IFRS 101 among Malaysian companies on Ace Market.

This study is significant for the following reasons. First, it extends previous studies by examining the degree of corporate compliance with mandatory disclosure requirements in Malaysia after the adoption of the International Financial Reporting Standards (IFRSs) by MASB in 2006. Hence, this study attempts to aid policy makers in any effort to educate companies on how to provide adequate information for investment and credit decision-making after the adoption of IFRSs. Since the adoption of IFRSs in 2006, no comprehensive studies have been conducted to examine companies compliance with the standards. The studies by Rahman (1998) and Lambert and Lambert (2003) provide insights on disclosure levels relating to specific IASs with a limited sample size. Rahman (1998) includes only 15 Malaysian firms whereas Lambert and Lambert (2003) increased the Malaysian sample to 20 firms. The current study by Mısırlıoğlu et al. (2013) documents that majority of the disclosure items required by IFRS were not disclosed by Turkish listed companies in 2005 (i.e. the year of mandatory adoption of IFRS).

Secondly, to date, no study had been conducted on the extent of compliance by companies in this new market- ACE Market. On 3rd August 2009, one of the significant changes in the Malaysian market structure took place when Bursa Malaysia s Main Board and Second Board were merged into a single board to form the Main Market, and the MESDAQ Market became the ACE Market. The ACE Market ACE stands for access, certainty and efficiency – is different because it is sponsored-driven and opened to companies of all sizes and from all economic sectors. In addition, there is no prescribed minimum operating history or profit track record requirements for entry to the ACE Market.

Lastly, a number of researchers such as Beaver et al. (1970), Bowen (1981), Lev and Ohlson (1982), Easton and Harris (1991), Strong (1993), Deechow (1994), Feltham and Ohlson (1995), Hodgson and Stevenson-Clarke (2000), Klapper and Love (2004), Olibe (2006), Larcker et al. (2011), Alali and Foote (2012), Dimitropoulos et al. (2012) and Lee (2012) have been involved in studies related to the stock market prices. These researches, which were conducted in various industries, different GAAP regimes, dissimilar countries, various currencies and diverse stock markets, provide inconclusive evidence that earning numbers, book values and other variables (e.g. size, leverage, and corporate-governance factors) could be a significant element to explain the share prices.

Specifically, the present study is the first study in Malaysia that presents evidence on the association between the stock market prices (i.e. CMAR) and other independent variables (i.e. earning per shares, firm size, leverage, independent board directors and percentage of shares owned by outside block holders) among companies of Ace Market. This study provides new insights and inputs to accounting regulators, accounting

practitioners, academicians and general users of corporate reports. Specifically, the following objectives are (1) to determine the cumulative market-return (CMAR) for fully and non-fully complied with IFRS 101 among Malaysian ACE Market companies; and (2) to investigate the factors associated with cumulative market-adjusted return (CMAR) among Malaysian ACE Market companies.

The rest of the paper proceeds as follows: section two presents the hypotheses development and research methods are described in section three. The results of the study are discussed in section four, and section five concludes the study.

20   Hypotheses development

Market Failure (Imperfection) Theory (MFT) is considered as the underpinning theory for the present study. MFT is associated with a market that is inefficiently supplying desired information and raises the problems of information as a public good and information asymmetry. A market failure or market imperfection is explicitly assumed to happen in the market for financial information when either the quality or the quantity of the information produced differs from what would be produced if only the private costs and benefits of the information were relevant (Riahi-Belkaoui, 2004).

In addition, Amir and Ziv (1997) investigated the timing and method of adoption of SFAS No. 106[1] "Employers' Accounting for Post-Retirement Benefits other than Pensions. In this study, they consider the trade-offs between early and non-early reporting of information to be released under the new accounting standards and predict that discretionary revelation of private information constitutes good news. The study also assumes that managers have private information about the accounting standards valuation effect and use the adoption timing choices to convey this information to the market.

Amir and Ziv (1997) also find that the market-adjusted return on a portfolio of 1991 adopters was significantly larger that the market-adjusted return on a portfolio of 1993 adopters. This result could suggest that companies with relatively unfavorable information are more likely to wait until the mandatory adoption date. In addition, Horton and Serafeim (2008) investigated that differences in earnings between UK GAAP and IFRS (using International Accounting Standard 19' Employee Benefits) and stock returns. The findings indicate that IFRS appears to provide a vehicle through which information is revealed in relation to specific adjustments given that differences in earnings between UK GAAP and IFRS are associated to stock returns.

 The present researchers involved in studies of accounting standards and market reactions are Alali and Foote (2012), Dimitropoulos et al. (2012) and Lee (2012). Using

1 The standard was effective for fiscal year starting December 15, 1992 (Amir and Ziv, 1997)

companies listed on the Abu Dhabi Stock Exchange (ADX), Alali and Foote (2012) provided evidence that earnings scaled by the beginning of period price are positively and significantly related to cumulative returns and EPS, and the book value per share are positively and significantly related to price per share. In contrary, Dimitropoulos et al. (2012) documented that Euro adoption has contributed to a decrease of association between stock prices and accounting information published by Greek listed companies. In another dimension of study, Lee (2012) investigated the readability of mandatory quarterly reports (10-Q) and the information efficiency of stock prices. He found that poor disclosure readability delays the market response to earnings news.

Given that previous inconclusive findings related to an association between stock prices and accounting information, this study thus anticipates that stock prices (i.e. the market adjusted returns 'CMAR') are associated to the extent of compliance with IFRS 101. Specifically, the CMAR of companies with full compliance to IFRS 101 is higher than partial compliance to IFRS 101 among Malaysian Ace Market companies. Therefore, the hypothesis is stated as follows:

> H1: The cumulative market adjusted return for full compliance with IFRS 101 is larger than partial compliance with IFRS 101 among Malaysian Ace Market companies.

In addition, Klapper and Love (2004) investigated the association between corporate governance and firm value. They suggested that good governance, which is positively related to market valuation, may increase the shareholder value. Therefore, this study would expect an association between CMAR and corporate governance variables that comprise independent board of directors and outside block holders.

2.1   Independent board of directors

Board independence is expected to play an important role in ensuring the management to comply with MASB approved standards in preparing the company s accounts. This is because failures to comply with the standards could lead to negative publicity which adversely affects the share price of the firms. Therefore, board independence is expected to be associated with CMAR given that outside directors are seen by the public as "decision expert and decision ratifications" (Fama and Jensen 1983). Therefore, the following hypothesis is developed:

> H2: The cumulative market adjusted return is positively associated with the percentage of independent board of directors.

2.2   Outside block holders

The presence of outside block holders is expected to have significant impact on the compliance with the MASB standards. This is because these outside block holders

could demand more information to be disclosed in the annual reports to ensure transparency and to reduce information asymmetry among the small shareholders. The evidence by Norita and Shamsul Nahar (2004) supports this contention where a positive and significant influence between outside block holders and the amount of voluntary disclosure was found. Furthermore, Shamsul Nahar (2004) found that outside block holders are negatively associated with financial distressed status. It is therefore predicted that the extent of ownership by outside block holders leads to compliance with MASB standards. This is because the wealth of these outside block holders is tied with the value of the firms. Any deviations from MASB standards lead to auditor to issue a qualified report which could adversely affect the market valuation of the shares of the firms. Thus, the extent of outside block holders' ownership provides a greater incentive for compliance with MASB standards. Therefore, the hypothesis is as follows:

> H3: The cumulative market adjusted return is positively associated with the percentage of shares owned by outside block holders.

3.0   Research method

Annual reports of all firms (banks and financial institutions will be excluded because they were subjected to a different legal requirement) listed on the Malaysian Ace Market for the year 2009 and collected either through mail or website search. The year 2009 is chosen because it was the last year before the introduction of the new FRS 101 (revised in 2009) which was to be complied by all Malaysian public listed companies starting from 1st January 2010. The results of the current study would indicate to what extent the companies are ready to comply with the new requirements (starting 2010). The Malaysian Accounting Standards Board (MASB) has required all listed companies to comply with the new accounting standard which resemble closely with the IAS issued by the International Accounting Standards Board (IASB) starting from 1st January 2006.

Following the exclusion of the finance companies, the remaining number of companies that were eligible for the analyses was 130. A total of 105 Malaysian Ace Market companies was used and examined in the present study given that 17 companies were listed on ACE Market in the year 2010 and 8 companies have no information related to CMAR and corporate governance variables.

3.1   Level of compliance

This study investigates the level of compliance on Financial Reporting Standards (FRS) 101, Presentation of Financial Statements among Malaysian firms listed on the ACE market. This standard contains 128 paragraphs with 105 disclosure items (see Azhar, 2012). A dichotomous procedure as adopted by Cerf (1961) is adopted. Similar

procedure was subsequently used by other researchers (e.g. Naser et al. 2002; Haniffa and Cooke 2002) This procedure is a simple approach by which an item scores '1' if it is disclosed, and '0' if it is not disclosed. The total disclosure (TD) score for a company is computed as follows:

$$TD = \sum_{i=1}^{m} d_i$$

where d = 1 if the item d_i is disclosed,

d = 0 if the item d_i is not disclosed, and

$m \leq n$ (discussed below)

The scoring is not a straightforward task since there were cases where companies did not mention an item of disclosure because the item is not relevant to them. If that was the case, a non-disclosure was not considered as a penalty. In contrast, if a relevant item was not disclosed, a score '0' was assigned, which thus constituted a penalty.
In deciding whether an item was of relevance to a company, several procedures used in prior literature were applied. Following Cooke (1989), each annual report was thoroughly read to ascertain whether an undisclosed information item was, in fact, irrelevant to a company.

Some of the earlier studies assigned weights to the disclosure items according to their importance to the users of financial reports (e.g. Buzby, 1974; Wallace, 1988; Chew and Lee, 1990). However, the disclosure items used in this study were not weighted because it was assumed that each item of disclosure was equally important. This assumption is expected to be valid since this study deals only with mandatory disclosure, where all items that are required by the standards are regarded as of equally high importance. In contrast, it would have been better to have the items weighted if they had been voluntary in nature.

An index was subsequently developed to measure the relative level of disclosure by a company. The index is a ratio of the actual scores obtained by a company to the maximum score possible. Since companies are not penalised for not disclosing irrelevant items, the maximum score (M) a company could earn varies:

$$M = \sum_{i=1}^{n} d_i$$

where   d = expected item of disclosure, and
           n = the number of items which the company is expected to disclose.

The total disclosure index (TDI) for each company then becomes TD M. The index

would thus lie between 0 and 1. A score of 1 indicates that a company disclosed all the relevant items as required by the standards and a score of 0 means that a company did not disclose any of the relevant items. The disclosures related to EPS, total assets, total liabilities, percentage of independent board directors, and percentage of shares owned by outside block holders were also collected from the annual reports. In addition, the share prices data are also extracted from DataStream database.

3.2   *Cumulative market-adjusted return (CMAR)*

Brown (1985) has initiated normal returns as either an arithmetic average of historical return or required return from the Capital Asset Pricing Model[2]. The latter method is called cumulative market-adjusted return (CMAR) which is also known as cumulative abnormal return (CAR). Hence, the methodology adopted by Amir and Ziv (1997) is replicated in this study. Sixty days of cumulative market-adjusted return (CMAR) prior to the date of adoption and ending 60 trading days after this date for each firm is computed. The filing date of the first quarterly report including information on the adoption of IFRS 101 is used as the date of adoption. Otherwise, the date when the annual report is released is to be used in the present study.
The CMAR will be calculated as follows:

$$CMAR_i = \prod_{t=-60}^{60} (1 + RET_{it} - KLSE\ Index_1) - 1,$$

RET_{it} = firm i's daily return at time t
KLSE Index $_t$ = the daily return on the KLSE index at time t and day 0 is day of adoption.

Subsequently, multivariate tests are conducted to determine the relationship between CMAR as dependent variable, corporate governance variables (i.e. percentage of independent board of directors and percentage of shares owned by outside block holders), and control variables (i.e. EPS, firm size, leverage) as the independent variables using the following regression estimates:

CMAR = f (EPS, SIZE, LEV, BDIND, OUTBLK)

Estimating CMAR Model, the dependent and independent variables are as follows:

CMAR = cumulative market-adjusted return (CMAR) prior to the date of adoption and
            ending 60 trading days after this date;

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2   Under this model, the market value of a firm can be written as the discounted present value of future cash flows of the firm. It aimed to explain how asset would be priced in relation to one another when their individual returns were risky (Brown, 1994)

EPS	= basis earnings per share;
SIZE	= total assets;
LEV	= total assets divided by total liabilities;
BDIND	= percentage of independent directors on the board;
OUTBLK	= cumulative percentage of shares owned by outside block holders with shareholdings 2% and above.

40   Results

This section discusses the results of descriptive analysis and multivariate analysis based on 105 Ace market companies.

4.1   *Descriptive analysis*

Table 1 presents a distribution of the sampled companies according to the level of their compliance with the MASB disclosure requirements. Distribution was computed for every sector and for the total sampled companies. The categories are full compliance, if the disclosure index is over 90%, partial compliance between 80% and 90%, average compliance between 70% and 79%, and below 60% which reflects a substantial gap between company disclosure practices and the MASB requirements.

Given the results presented in Table 2, all sampled companies in all industry sectors were found to have at least 82% compliance level. This result suggests that Malaysian companies listed on the ACE Market of Bursa Malaysia (Malaysian Stock Exchange) complied with the majority of MASB disclosure requirements, with the lowest disclosure index of 82.5% for the companies in the technology sector.

In particular, 72% of the sampled companies have a disclosure level of more than 90% and 28% have a disclosure level between 80% and 90%. This result indicates that most of the sampled companies meet the high compliance level. Seven companies achieved the highest level of disclosure score of 100%. Overall, the average compliance rate was quite high at 92.5%.

Table 1:

Distribution of sampled companies according to their level of compliance with FRS101

Disclosure level range (%)	IP	CP	TECH	TS	Total sample No. (%)
Over 90%	12	1	50	13	76 (72%)
80% - 90%	4	-	21	4	29 (28%)
70% - 79%	-	-		-	-
60% - 69%	-	-	-	-	-

Disclosure level range (%)	IP	CP	TECH	TS	Total sample No. (%)
50% - 59%	-	-	-	-	-
Less than 50%	-	-	-	-	-
	16	1	71	17	
Total	(15%)	(1%)	(68%)	(16%)	105 (100%)
Max. disclosure level	100	91.11	100	100	100
Min. disclosure level	84.09	91.11	82.5	83.33	82.5
Overall disclosure level	92.51	91.11	92.34	93.18	92.49

IP-Industrial Product; CP-Consumer Product; TECH-Technology; TS Trading and Services

These results indicate that most Malaysian companies listed on the Bursa Malaysia comply with the disclosure requirements as required by the MASB standards. This reinforces the usefulness of evaluation of the factors influencing companies' compliance with MASB-required disclosures.

Table 2 presents the descriptive statistics of continuous independent variables included in the present study. The mean of EPS among companies listed on Malaysian Ace Market is -2.12 cents and the minimum (maximum) is -77.94 cents (15.59 cents). The average of log assets (SIZE) is 7.5026, while the minimum (maximum) is 5.29 (8.87). Additionally, the mean of leverage (LEVER) which is total liabilities divided by total assets is 0.3 699. The average percentage of independent board directors (BDIND) among Malaysian Ace companies is 45.82% and the maximum is 100% (i.e. Infortech Alliance Bhd) while the minimum is 25% (i.e. HDM Carlaw Corporation Bhd).

Table 2

Descriptive statistics of continuous independent variables

	Mean	**Min**	**Max**
EPS (cent)	-2.12	-77.94	15.59
SIZE (logAsset)	7.5026	5.29	8.87
LEVER	0.3699	0.00	3.85
BDIND	0.4582	0.25	1.00
OUTBLK	29.32	0.00	88.21

OUTBLK is the cumulative percentage of shares owned by outside block holders with shareholdings 2% and above; BDIND is the percentage of independent directors on the board.

The cumulative percentage of shares owned by outside block holders with shareholdings of 2% and above (OUTBLK) shows that Kellington Group has the highest outside block holders (i.e. 88.21%). On the other hand, there are 13 companies which have zero percentage of outside block holders. The mean of OUTBLK for Malaysian Ace Market companies is 29.32%.

There are a total of 76 Malaysian Ace Market companies that fully (i.e. over 90% of total disclosure) complied with IFRS 101. On the other hand, 29 companies have partially (i.e. 80% - 90% of total disclosure) complied with IFRS 101 for the year 2009.

Table 3

Descriptive statistics of CMAR

	Mean	**Min.**	**Max.**
CMAR			
Full compliance companies	1.068	0.000	2.08
Non-full compliance companies	0.985	0.000	3.70

Table 3 illustrates the descriptive statistics for CMAR. Using t-test, this study finds that CMAR for fully-complied companies (i.e. disclosure level of more than 90%) and non-fully-complied companies (disclosure level between 80% and 90%) is significant at 1 percent level. In other words whether the companies fully or non-fully complied with IFRS 101, the CMAR is positive and significant for both groups. Table 2 also provides evidence that the mean of CMAR for fully-complied companies is higher than non-fully complied companies.

In addition, the t-test indicates that there is no significant difference of CMAR between fully-complied companies and non-fully complied companies. Other reasons or variables may cause the association between CMAR and fully-complied companies and/or non-fully complied companies.

42   Multivariate analysis

The Pearson correlations statistics for all continuous independent variables of interest are presented in Table 4. A high correlation between leverage (LEVER) and total assets (SIZE), percentage of independent directors on the board (BDIND) and SIZE has been observed for Malaysian Ace Market companies.

Table 4

Pearson correlation matrix

	EPS	SIZE	LEVER	BDIND	OUTBLK
EPS	1.00	-0.152	-0.059	0.019	0.032
SIZE		1.00	0.537**	0.276**	0.177

	EPS	SIZE	LEVER	BDIND	OUTBLK
LEVER			1.00	0.146	0.164
BDIND				1.00	0.073
OUTBLK					1.00

**. Correlation is significant at the 0.01 level (2-tailed).

However, the other variables are not associated as illustrated in Table 3. Ordinary regression is run using all the independent variables resulting that none of the variance inflation factors (VIF) are greater than 2.5. This indicates that multicollinearity is not a cause for concern in this study.

Table 5

Results of estimating CMAR model: Regressions of CMAR and independent variables

$$CMAR_{it} = \beta_0 + \beta_1 \, EPS + \beta_2 \, SIZE \, \beta_3 + LEV + \beta_4 \, BDIND + \beta_5 \, OUTBLK + \varepsilon_{it}$$

Intercept	0.7358
	(0.000*)
EPS	-0.049
	(0.620)
SIZE	-0.196
	(0.109)
LEV	0.086
	(0.459)
BDIND	0.200
	(0 .050*)
OUTBLK	-0.035
	(0.724)

** Significant at the 0.01 level (2-tailed).

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* Significant at the 0.05 level (2-tailed).

Adjusted R	0.229
Durbin-Watson	2.062

The CMAR Model in Table 4 provides evidence that an announcement of earnings whereby EPS which is used as a control variable reveals that there is no significant association between CMAR and EPS among Malaysian Ace Market companies. The statistical findings also show that other control variables (i.e. SIZE and LEVER) are not significantly associated with CMAR. However, this study does not reject hypothesis 2 given that the coefficient of corporate governance variable (i.e. the percentage of independent directors on the board 'BDIND') is positively and significantly associated to CMAR.

This positive association implies that higher percentage of independent directors on board is a significant corporate governance policy. These findings are consistent with the study by Klapper and Love (2004) who claimed that adopting good corporate governance policies may help companies to increase their shareholder value. In other words, companies with higher percentage of independent directors seem to offer higher cumulative market adjusted returns among Malaysian Ace Market companies.

However, the variable of OUTBLK which was measured by the cumulative percentage of shares owned by outside block holders with shareholdings 2% and above does not support hypothesis 3. These findings are not consistent with Larcker et al. (2011) who provide strong evidence that abnormal returns are increasingly negative for firms with a greater number of large institutional blockholders (i.e., those holding at least 1% of shares outstanding).

Table 5 further indicates that the adjusted R^2 is 22.9% which can be explained by the corporate governance variables and control variables. In addition, Durbin-Watson value is 2.062 which indicates that there is no serial correlation between errors. The Durbin-Watson test statistic can vary between 0 and 4 with a value of 2 means the residuals are uncorrelated (Field, 2009).

5.0   Conclusions

Malaysia is on the track to achieve full convergence and adoption of the International Financial Reporting Standards (IFRSs) by 2012. This situation has motivated to study the extent of compliance with IFRS 101 'Presentation of Financial Statements' before the effective date. The findings show that majority of Malaysian Ace companies have complied with IFRS 101.

In addition, the results indicate that the Cumulative Market Adjusted Return (CMAR) is positive and significant for both partial and full compliance of IFRS 101 among Malaysian Ace Market companies. Using multivariate regression analysis, an announcement of earnings (i.e. EPS) provides a lack of significant association

between CMAR and EPS. Nevertheless, the percentage of independent directors on the board (BDIND) is found to be a significant variable that associates with CMAR. These findings imply that policy makers and regulators should encourage Ace Market companies to have the most optimal number of independent board directors for future improvements of CMAR.

The limitations in methodology may restrict the generalisability of the findings. The sample is limited to non-financial companies listed on the Malaysian Ace Market. Hence, the findings may not be applicable to financial and small companies. There is also a limitation of the method employed in determining the adoption date of IFRS 101 that could result other findings.

Future research could be extended to all main listed companies which are fully, partially and non-complied with MFRS 101 using Malaysian capital market. Given that an ideal capital market as one where the security prices at any time 'fully reflect' all available information and prices provide accurate signals for resource allocation (Fama, 1970), future research may be worth investigated using Market Failure (Imperfection) Theory (MFT) which is associated with a market that is inefficiently supplying desired information and raises the problems of information as a public good and information asymmetry.

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